DOW THEORY LETTERS INC.

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June 20, DJIA 855.44; PTI 377; A-D ratio -26.47
June 27, DJIA 873.12; PTI 403; A-D ratio - 25.54

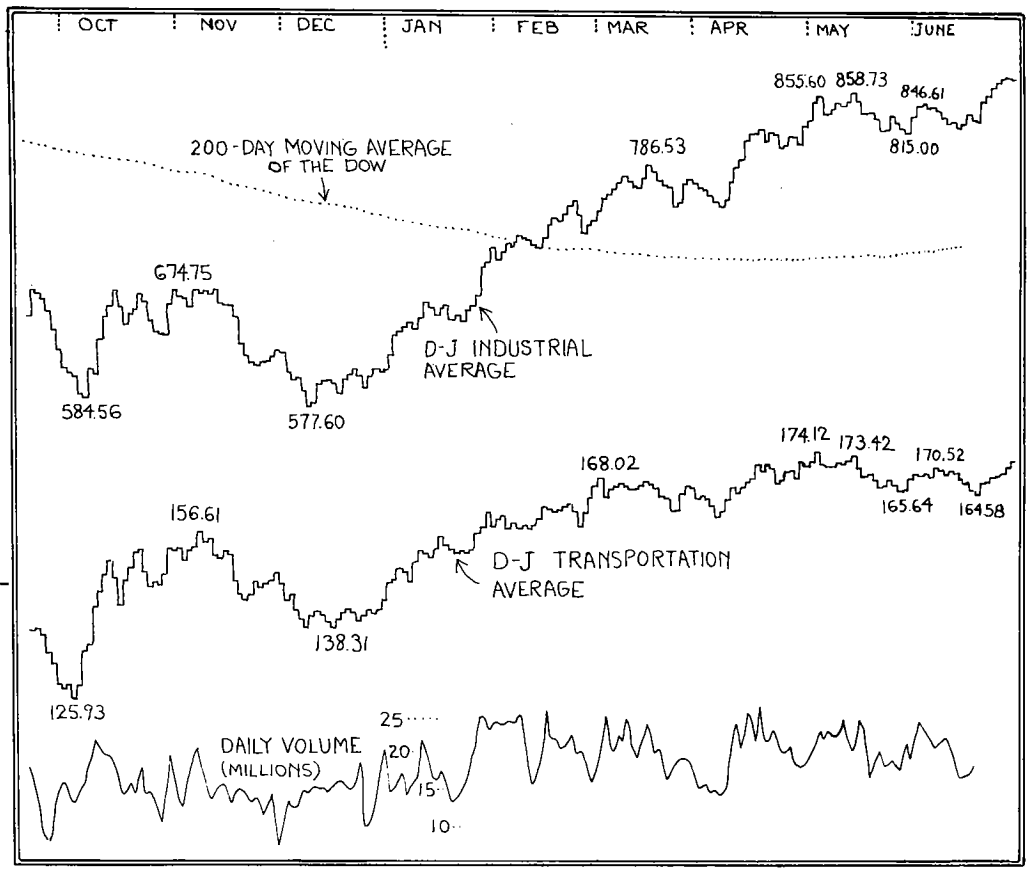
START: In this issue, I say a lot about gold. I have included Elliott work by A.J. Frost, and I am pleased to be the publication that presents this leading Elliott interpreter's concepts to Wall Street. Next, I write a good deal about confirmations according to Dow Theory. During a primary bull trend, we have to bow continually to the power of the upward forces, and this bull market has been no exception. Towards the end of the report I present my opinion of the dollar from the technical standpoint. This is something no one else seems to do. My conclusions are bullish for the dollar, and by implication for dollar securities from A to Z. Finally, I want to take a few days off and ponder stocks, Wall Street, the world and my own head. Therefore, I am allowing two weeks between this Letter and the next, which will be mailed on July 16th.

DOW THEORY & CONFIRMATION PRINCIPLE: I've been writing about the Dow Theory and the basic confirmation principle for the past 18 years. The confirmation part of Dow's Theory was resisted by analysts for many years, usually on the basis that "the Rails were an antiquated industry and no longer representative of the shipping capabilities of the nation." On January 2, 1970 Dow Jones rectified this situation by substituting six airline stocks, two truckers and a freight forwarder in the Rail Average. With this action, the argument about modernization of the Rail Average died out, and the D-J Transportation Average was born.

According to Dow's Theory, the Industrial and Transport Averages must confirm each other by penetrating preceding points in order to provide valid inferences of the price movement. A movement of one Average, unconfirmed by the other, is more likely than not to be deceptive.

Dow's Theory places no time limit on the confirmation principle, but it has been my observation that the more forceful the confirmation, the greater and more dramatic the ensuing movement (for instance, the historic upside confirmation by the two Averages on January 27, 1975). By the same token, the more flagrant the non-confirmation, the greater the expectation of an important reversal of the trend (i.e., the trend that produced the non-confirmation).

Very few market students actually realize what has happened to this market from the Dow Theory confirmation standpoint since 1966. So at this time I want to review the 10-year history. Please refer to the monthly (high-low) chart of the D-J Industrial Average (page 2). In February, 1966, the two Averages advanced to historic highs, Industrials to 995.15, Transports to 271.16 (note, under Dow Theory, only closing figures for the Averages are used). Those were the last confirmed closing highs for the two Averages. At no point, following February, 1966, did both Averages close higher. Because of the great speculation, the miniscule stock yields, the frenzied activity in low priced issued, the great time span of the bull market and a number of other considerations, I called the bull market's end in February, 1966. I concluded that from that point on, a primary bear market was in progress.



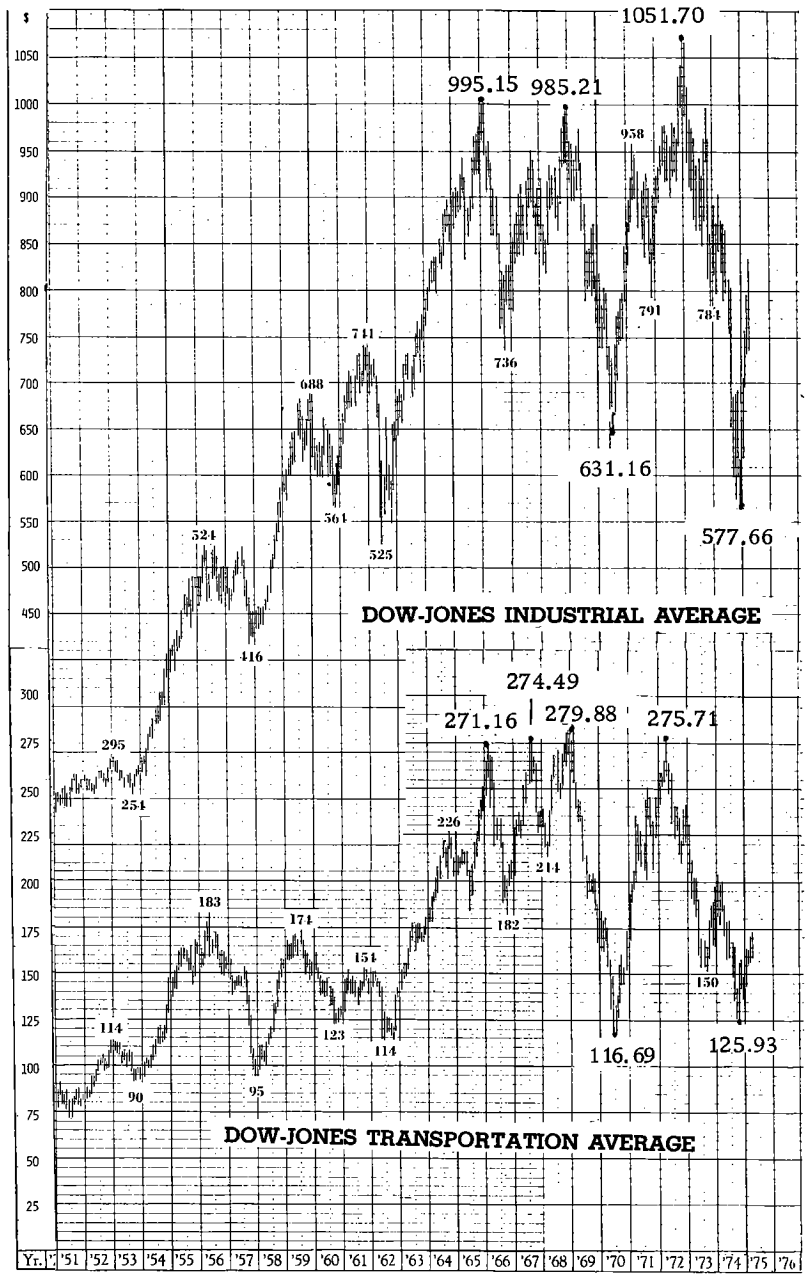
Now note this fascinating sequence. Following the 1966 peaks, the Averages turned

down, hitting lows in late 1966.

An advance then took Transports (the Rails at that time) to a new closing high of 274.49 in 1967 (unconfirmed by Industrials) and yet another new historic high of 279.88 in February, 1969. As seen on the chart, the Industrials rose to 985.21 (December, 1968), but this peak was a full 10 points below the 1966 peak. In the face of the flagrant Industrial non-confirmation, the market dropped precipitiously to the 1970 lows.

The 1970 lows were 631.16 for Industrials, 116.69 for Transports. From there, a new bear rally began, and this advance was extraordinary in its power. On January 11, 1973 the Industrials recorded an all-time high closing of 1051.70. The Transports had hit 275.71 in early 1972, but by the time Industrials were establishing their new high, Transports were already heading down. Here again, the non-confirmation principle (this time, the flagrant non-confirmation and divergence in Transports) turned the trend violently down. The 1973-74 smash was one of the worst in Wall Street annals. Yet at the highs the Averages had never provided louder danger signals.

On October 3, 1974 the Transports touched a low of 125.93. A day later (not shown on chart) Industrials plunged to 584.56. A rally followed, then a new dive into December. But despite the new bear market low of 577.66 for Industrials, Transports refused to break below the October 125.93 level. Furthermore, and this was most remarkable, the 1974 low of 125.93 for Transports was actually 9 points above the previous 1970 low of 116.69!



The amazing strength and the series of non-confirmations in (of all things) the much-maligned Transportation Averages served to turn the tide. The market roared up from its October-December lows. On January 27, 1975, the Dow Theory provided a primary bull signal, and the primary trend turned from bear to bull. This is the big story as it has been told from the 1966 highs (monthly chart this page courtesy of Horsey, Salisbury MD 21801).

NEAR-TERM: Having reviewed the price movement from the long-term standpoint, I now want to discuss the market from the standpoint of the price movement since May. I realize that it is not easy to follow the logic and the action of the market in these areas, but I consider it vital that subscribers try (with enough study, it does make sense). To operate in the market without a working knowledge of the price movement is tantamount to driving from New York to California without a road map. You might make it, but the odds are that before you get to the Rockies you'll either buy a map or a b ottle of Librium.

So here goes: As you can see on the page 1 daily chart of the Averages, the two D-J components recorded their 1975 (last confirmed) highs on May 5 at 855.60 for Industrials and 174.12 for Transports. Next, a slight recession occurred, but during the May 14 attack on the highs, Industrials recorded a new 1975 peak of 858.73. Transports failed by .70 to confirm. This meant that May 5 stood as the day of the last confirmed highs (under Dow Theory, a movement is taken to terminate on the day when the Industrials and Transports set their last confirmed highs).

Follow the May 14 non-confirmation, the two Dow components sank to the late-May lows of 815.00 for Industrials, 165.64 for Transports. At this point volume dried up, and it was clear that the Averages were ready for another try at the upper levels. As you can see on the page 1 chart, this rally quickly ran out of steam with Industrials touching 846.61 on June 2, Transports hitting 170.52 on June 6.

Again the Averages turned down, and this time the Dow components gave us a clear downside non-confirmation. On June 12,

Industrials recorded a low of 821.03. Four trading days later, on June 18, Transports hit a low of 164.58. Thus, Transports broke below their May low while Industrials held 6 points above the 815.00 May low.

Spurred on by the technical impetus of the June 18 downside non-confirmation, a new rally got underway. On June 23 (last week) the Industrial Average pushed through the 1975 high of 858.73 with volume rising sharply. The Transports, sluggish at first, then began to join the parade. On June 27 the Transports accomplished their first technical feat since May, by rallying above a previous peak. The peak, as you can see on the page 1 chart, was the 170.52 high of June 6.

As this is written, the overriding question is whether the Transports will now complete the job and and rally above their May 5 peak of 174.12. If they do, we could well see a "rebirth" of power on the upside for this primary bull market. Conversely, a persistent refusal to confirm on the part of Transports will serve as a warning of trouble ahead.

I should add that the majority of upside penetrations during a bull market are confirmed in due time by the other Average. Thus, we should continue to give credence to the bull forces, and at this point we should place our betting odds on the probability of an ultimate Transport confirmation (above 174.12).

* * * * *

The A-D line of the 30-Dow stocks (see last Letter) has now confirmed by rising to a new 1975 high. The cumulative index of the most-active stocks (also last Letter) has also pushed to new 1975 highs as has the A-D ratio for the NYSE and the Primary Trend Index. Odd-lotters remain heavily on the sell side.

This bull market is one of the most remarkable I have ever seen or studied. Its action since mid-March has been "weird" in that one technical indicator after another has gotten badly out-of-gear, only to move back into harmony as still another indicator diverges. Nevertheless, the trend continues up, propelled by the mysterious force of the primary bull trend. Despite suspicions, divergences, non-confirmations, warning signals, the bull has the market on its horns. That's been the story during all of 1975. It has not changed.

GOLD AND ELLIOTT: I just received a letter from Mr. A. J. Frost of Canada, in my mind the greatest living interpreter of the Elliott Wave Principle. Mr. Frost did a great deal of outstanding work with Hamilton Bolton, founder of the famous Bank Credit Analyst. Between them they revived interest in Elliott in the 1960's, and that interest is greater today than ever. I would unhesitatingly say that if it had not been for Bolton's and Frost's efforts, Elliott would be unheard of today.

In Frost's latest letter to me, he outlined his thoughts regarding the gold picture. I consider it a privilege to be able to present those opinions to my readers at this time.

Almost all Bolton's and Frost's Elliott work was done on logarithmic-scaled charts, as they felt that log (ratio-scaled) graphs best showed the various thrusts of the price move-

ment. Thus a rise of 2 to 4 shows as exactly the same vertical distance as say a rise from 45 to 90 on ratio scale).

I am including this tracing of the chart which Frost sent me. Frost writes: "The enclosed weekly gold chart (London morning and afternoon fix prices) shows a strong Elliott pattern. I have marked on it my Elliott reading. It is important to note that the B Wave of the correction travelled into new high ground, indicating strength. This type of consolidation tends to generate a strong upward thrust. I would say that when the price of bullion breaks out of the pattern contained by its upper trendline (X on chart), the market price of bullion will quickly advance and exceed in amplitude the rise from the 1972 low to the March high of 1974, based on Elliott rules."

Note that Frost places the first cycle peak for the gold bull market at point V (just under 180). He obviously believes that gold at point V completed the first major bull cycle of what will be a super-cycle in gold.

Most readers (gold fans included) will probably be surprised at Frost's interpretation of the gold bull market having started in 1972 and ending in 1974 — rather than ending at the 1975 all-time high. However, those who read my Letter 632 are familiar with the Elliott A-B-C "flat correction," in which the B leg often betters the preceding bull market high (as was the case with the Dow in 1973).

Thus, according to the chart, the bear market correction for gold began at point V in 1974 and has already progressed through the A, B and a large part of the final major C wave. As you can see, the major A-B-C correction has assumed the form of a 3-3-5 (these are the breakdowns of the larger waves) correction. Currently, we are completing smaller leg 5 of major downward wave C. This should be the final leg down before the new major bull market in gold begins.

How far could leg 5 travel? The 1974 breakout point (see point & figure chart in last Letter) was 160, and this implies that 160 should be an important support level. But it may be that before the next primary bull market in gold, the market is going to have to "flush out" all the weak hands, and really turn all but the very strongest interest bearish on the future of gold. To do this, gold could break the 160 support level and perhaps drop down to test the 150 level, perhaps even temporarily provide a "panic breaking" of 150.

However, I believe we are getting closer to an important juncture in the gold story. Nobody can tell you how to make the "perfect play" in gold. Some like to average down, others like to buy on a upside breakout. I like to take a token position, "get my feet wet," then add to my position as the market gives consecutive technical "OK's." That is the reason I suggest token positions of up to 15% of assets split between Krugerrands and Homestake.

I want to watch the 160-161 level on gold carefully now. If gold touches those levels it should bring out selling. If not, then I suspect the technical test is over, and we will shortly start up. In that case, a breaking of trendline X on the chart, which is now at the 170 level, should signal the beginning of the next gold bull market. If and when that happens, I will give my thoughts on why, how, and what to do.

GOLD NOTES: As I have been pointing out, the pressure is towards higher costs at the S. African mines. Black workers, despite all kinds of threats, are organizing, and 20 fledgling black workers' unions are now in existence. The movement will grow. At this point the black unions are interested only in higher wages. This clip from S. Africa's Financial Mail shows what is happening with black miners' pay. It's moving up, up and up.

RISING WAGE TREND

Minimum rates for Black underground workers (cents per shift)

June 1 1972	50
May 1 1973	65
December 1 1973	72
June 25 1974	120
December 1 1974	160
June 1 1975	220

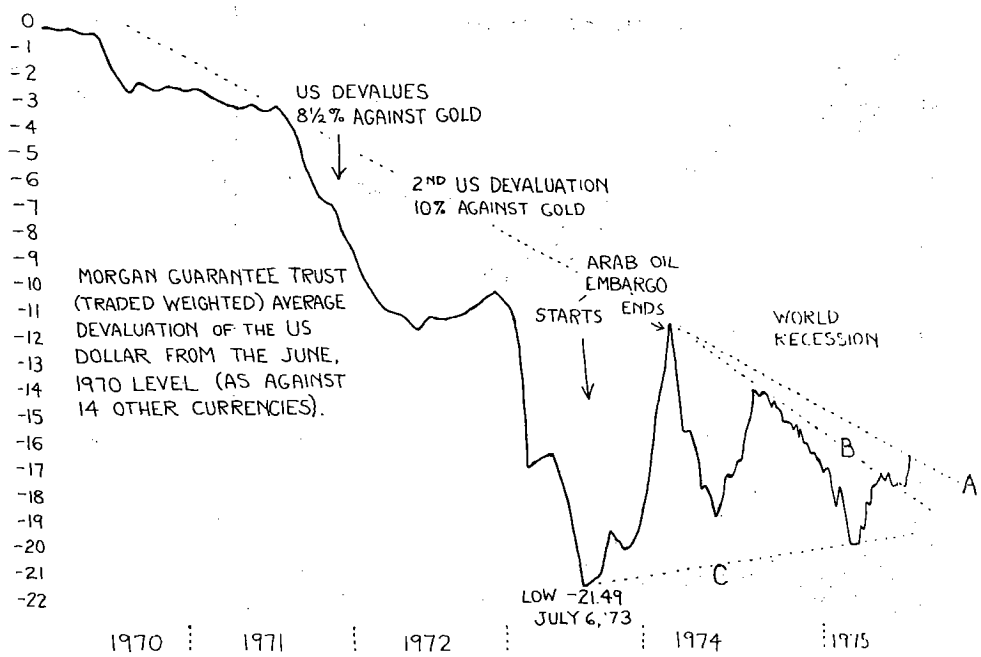
In Canada we have a situation where natural resources are owned by the provinces but export of resources is controled by the Canadian Government — with both having the right of taxation. Taxes, in many cases, as absurd, and this has hurt Canadian mining and dampened interest in mining shares in Canada.

How can one take a position in gold? One way is with Homestake. Here you have an American company, but the disadvantage is that about half its earnings come from gold, the rest from base metals (zinc, lead). However, there is also an interesting uranium play.

Probably the purest gold play is an investment in gold coins such as the S. African Krugerrands, which can be squirreled away in your bank vault. Advantage: It's gold in your hand, it's yours. Disadvantage: You're losing income by speculating in gold (anytime you purchase something of value in the hopes that it will go higher, you are speculating — unless that item provides a return. Then it's an investment. Bullion is a speculation because it yields nothing. A second way of playing gold is via gold futures. Here (depending on the brokerage house) you buy in mulitples of 100 ounces of gold for future delivery of up to one year. You put down as little (in some cases) as 10%. Commissions run around $40 to $50 round trip. You're taking a position in gold while shelling out only part of the final payment, but remember, you own that gold. If it goes up, you win, if it goes down, you lose. But you don't have to pay interest on the contract, so that if you put down say 15%, you can collect interest on your remaining 85%. That's an advantage over paying out the full price of 100 ounces of gold and putting the gold in your vault.

Of course, another way of playing gold is to buy shares in a good gold mutual fund such as International Investors, and let John

Van Eck and his boys worry about how they're going to work it. So far, they've done a good job. Disadvantage here: The loading charge, which varies from only a few percentage points on large commitments up to 8% for small commitments.



GOLD OPINION: I've told the gold story as I see it on the charts and as it could shape up technically. How do I feel about it otherwise? Frankly, I'll have to admit that I don't feel the big gold move in my guts, at least not now. I see the gold shares popping up, but I see gold bullion standing still. Are the shares trying to outguess the end of the stock market advance and are they readying themselves for a counter move against the market? Are the gold share traders just amusing themselves—rather than dying of boredom? Or is the whole move predicated on a coming collapse of the British pound? I don't know, but I do know one thing — the market and the technical considerations make the moves, not Richard Russell's gut feelings.

A STRIKING NEW DEVELOPMENT: I am including here my weekly chart of the trade weighted dollar and its action against 14 other currencies. This is a chart which probably no other service keeps, so what you see here is not generally seen, known or understood!

The dollar moved down against other currencies from 1970 to July, 1973. The dollar rally into 1974 was halted by the oil embargo and later by the world recession and the surge of hard money overseas. But note that the July 6 low for the dollar still stands and the rising trendline (C) since then traces the slow but subtle improvement in the strength of the dollar. Long-term trendline A on the chart traces the six-year descent in the dollar's strength. Throughout 1975, however, I have been insisting that the dollar is the world's most undervalued major currency. The chart is beginning to bear me out.

Last week the dollar broke up through intermediate trendline B, showing the dollar to be at its strongest level of 1975. The dollar should shortly push above trendline A, thereby reversing the long descending trend of dollar weakness. If that happens, we could see the beginning of a concerted and major move by foreign interests into dollars, US bonds and US stocks. If so, we will be seeing a resurgence (perhaps temporary) of US power and a basically bullish undertone for the US markets across the board from stocks to bonds.

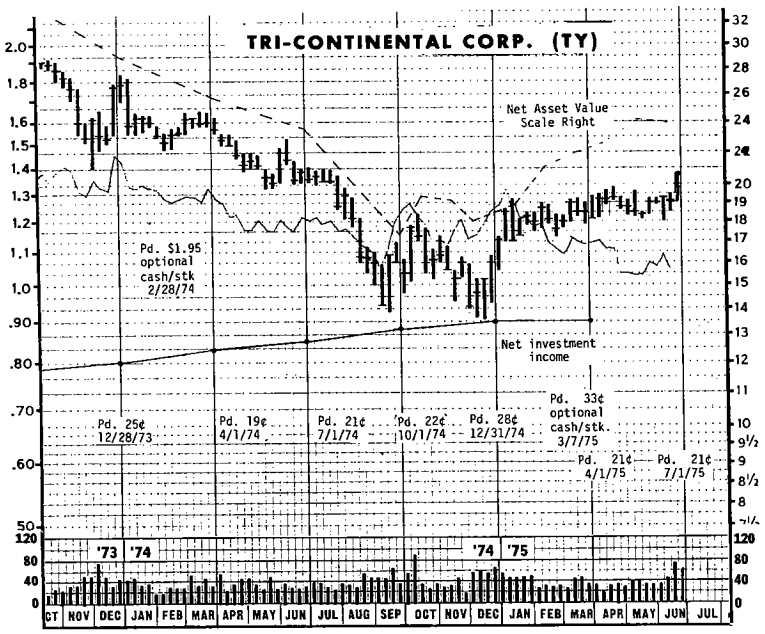
A strong dollar would not be bullish for gold, and this bothers me about the gold picture. If trendline A on the trade-weighted dollar chart is penetrated upwards (and I believe it will), then the major reason for a fundamental gold rise would be monetary inflation here, overseas or both. And I guess all this is why I've been holding subscribers' gold commitments down to only 15%. Note: The strengthening dollar is one reason why gold (in terms of dollars) has not "looked" better this year. Continuing strength in the dollar will obviously tend to hold back the dollar price of gold .

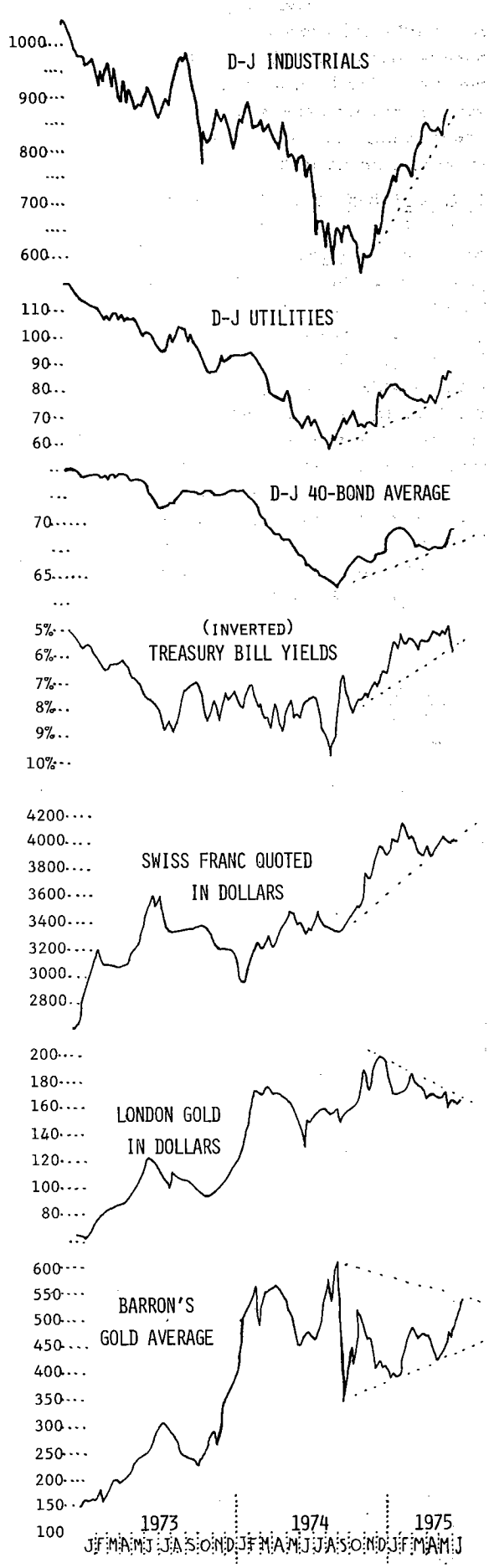
THE DOLLAR COMPARED: Everyone mouths clichés about the dollar's being weak, soggy, rallying, undervalued, on and on. I keep a chart (page 6) which provides me with a fairly quick reference as to the worth of the dollar in terms of seven very important items. The chart doesn't do any "mouthing," it tells us exactly what has happened.

At the top of the chart we see that in terms of dollars, the D-J Industrials collapsed during 1973-74. In October, 1974, you could have bought the Dow at a 44% discount from its January, 1973 price. Now that discount has shrunk to 18%. In each case the trendline on the chart connects the October value (and this is where the current bull market began) with the latest value. Thus we can see the trend of the item against the dollar over the last eight months or since the bull market's inception.

It is interesting to note that since January, 1973 the first four items have decreased in terms of dollars. On the other hand, Swiss francs, gold bullion and Barron's gold Average have increased in value vs. the dollar.

But since October, 1974 only gold has declined against the dollar and Barron's Gold Average (heavily weighted for ASA) is about even with the dollar (although down from the 1974 high).





Conclusion: Since January, 1973 Swiss francs, gold and gold shares have appreciated against the dollar. Since October-December, 1974 the appreciation has been in stocks, bonds, and Swiss francs with gold items about at a standstill.

TRI-CONTINENTAL: In Letter 633 I wrote about and recommended the stock of Tri-Continental (TY), the largest closed end fund. The Letter reached subscribers on a Monday when the stock was 18 1/4, at which price it was selling at a 25% discount from net assets. Since then TY has moved up to 21. This represents a 17% rise for the stock, and at this juncture TY is selling at a discount of about 15% from net assets which are $25. Thus, investors (hopefully, many of them my subscribers), have seen the value in TY and purchased the stock at the bargain prices of a few weeks ago.

As you can see on the weekly chart, TY has now pushed out of its whole recent six-month range, and from here on it should move with the market. I happen to think that TY is still one of the best vehicles for the average investor — as far as participating in this bull market. TY has a long record of dividends payments plus distributions from investments, and in the past the combined return from both has meant a yield of 15% or more on the stock (remember, however, that stocks sell minus the dividend and distribution once those payments are made). The chart of TY is courtesy of Securities Research Co., 208 Newbury St., Boston MA 02116.

Note: In the last report I talked and asked about Xerox. I got a great deal of information from subscribers, but perhaps the most telling information of all was computed by one excellent technician. Since 1973 there have been thirteen sales of Xerox stock by insiders, three of them in the $400,000 class or over. Over the same period there has been only one insider purchases, and that was for $9,250. The company is running into stiff competition and cumulative rental placements have been well below plan. I will be watching this stock closely because of my interest in the amazing Telecopier (through which written material can be sent over the telephone to all parts of the world), but maybe it's the old story, which is that the market knows all.